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Neeru Chaudhry, Hue Hwa Au Yong, Chris Veld

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Neeru Chaudhry, Hue Hwa Au Yong, and Chris Veld[1]

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Abstract

We examine the effect of the funding status of defined benefit (DB) pension plans on company tax avoidance behavior. Our results reveal that firms engage more in tax avoidance when the pension deficit, defined as pension liabilities minus pension assets scaled by total assets, increases. We find that for an average pension deficit firm one standard deviation increase in pension deficit is associated with annual tax savings of $3.64 million. For 2014 we find that, on the aggregate level, for firms with underfunded DB pension plans a one standard deviation increase in pension deficit is associated with annual tax savings of more than 2.7 billion dollars. Our results hold after controlling for factors such as profitability, financial constraints, operating losses, and foreign income.

Keywords: *Tax avoidance, tax planning, defined benefit pension plan, pension deficit, underfunded pension plan*

JEL Classification: G32, H26, J32

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[1] Neeru Chaudhry (Email: neeru.chaudhry@monash.edu), Hue Hwa Au Yong (Email: huehwa.auyong@monash.edu), and Chris Veld (Email: chris.veld@monash.edu) are all from the Department of Banking and Finance of the Monash Business School at Monash University in Melbourne (Australia). The authors are grateful to Hazel Bateman, Yangyang Chen, Dean Hanlon, Darren Henry, Elaine Hutson, Randall Morck, Donald Stokes, Madhu Veeraraghavan, Terry Walter, and participants at the Financial Markets and Corporate Governance Conference (FMCGC) 2014 in Brisbane, the Accounting and Finance Association of Australia and New Zealand (AFAANZ) Conference 2014 in Auckland, and a departmental seminar at Monash University for helpful comments and suggestions.